

CHAPTER 4

PUBLIC FINANCE MANAGEMENT SYSTEM IN SOUTH AFRICA

4.1 INTRODUCTION

The public finance management system in South Africa has gone through fundamental changes and is still under transition, especially after South Africa's democratization in 1994. These fundamental changes in public finance are characterised by the fact that public service, in general, in South Africa has evolved as well and is still in the process of transformation. On the basis of the public service transformation in general and public finance in particular, institutional design and the mindset of public servants in general have to respond to the transformation taking place in the Public Service.

Therefore, managerial leadership should be skilful both conceptually and technically, especially in public finance systems and governance in general. It is because a skilful leader should be able to ensure that government objectives, particularly in implementing the PFMA are maintained. Hence, this chapter discusses the theory of public finance and provides differential conceptual analysis of 'budget and budgeting system' as sometimes used interchangeably, which is an evolution of public finance in South Africa, especially with the introduction of Medium Term Expenditure Framework (MTEF). It is because MTEF influences the budgeting system, planning and budgeting, including financial planning and management. This chapter outlines the budgeting system in South Africa and the role-players within the budgeting process in order to explain the dynamic nature of the public finance management system in South Africa.

4.2 EVOLUTION OF THE PUBLIC FINANCE MANAGEMENT SYSTEM IN SOUTH AFRICA

Research indicates that in the past, the South African budgeting system was secretive. There was no open formula for funds allocation for the country. Again, literature reveals that the budget was a matter of the executive, meaning that the executive was at the forefront of compiling the budget, with less role for Parliament. Parliament was simply 'rubber-stamping'

what the executive has compiled. Due to the secretive nature of the budgeting process, it was difficult to analyse and scrutinise service delivery trends and conduct financial analysis because budget documents were not accessible. As a result, accountability and transparency suffered as elements of good governance.

The former Department of state Expenditure and the function Committees determined budget allocations. These committees were responsible for co-ordinating budget proposals and distributed allocations for a given function, like health or education (Walker & Mengistu, 1999:58). This confirms that the executive was the major role player when it comes to budget process, particularly allocations to spending departments and parliament's role was minimal.

Undoubtedly, the budget process or allocation was no two-way process, inclusive and participatory. In essence, the budget process was not inclusive and highly centralised. For example, the function committees were very exclusive in approach and reflected control of funds rather than managing funds for service delivery improvement. As a result in 1995, these committees were disbanded (Walker & Mengistu, 1999:58).

The above description of past processes was based on a traditional form of budgeting, namely the line-item budgeting system. Again, the Exchequer and Audit Act of 1975 reflected the basis for expenditure control because the Act was not intended to 'manage' public finances, but to 'control' them. Additionally, the Act was too prescriptive, meaning that there was no option for flexibility as it was based on rules.

As Abedian, Strachan and Ajam (1998:54) explain traditional budgeting focused on expenditure controls and the aim was simply to keep control over money spent on government. For example, with regard to its objective or aim, the Exchequer and Audit Act states that the Act regulates the collection, receipt, control of state property and monies of the state (Exchequer and Audit Act, 1975:2). Given the objective of the Act, it is evident that the Act was input and control-oriented rather than focusing on results and management. Due to the administrative nature of public finances, accounting officers were not active within an organisation because management culture was not the order of the day, the organisational culture was rule-bound, with less flexibility and delegation. Service delivery was not customer-oriented, as a result value for money suffered. The Exchequer Act operated within a traditional budgeting system like line-item budgeting system, which was not results-focused, but input-

oriented. With regard to the item budgeting system, an input-focused management and budgeting are oriented towards how much resources, staff and facilities, are made available for a programme or ministry (Organisation for Economic Co-operation and Development, 2002:8). The OECD's view on the item-budgeting system clearly indicates that a traditional approach to budgeting as outlined by the OECD was not focused on results or outcome; the latter is crucial in the modern public management.

Since the transition to democracy, the new constitution demands transparency and accountability on matters of governance. In 1998/9, the medium term expenditure framework was introduced in South Africa in order to encourage the participative approach in budgeting process, transparency, accountability and policy-budgeting co-ordination.

The introduction of the PFMA also encourages effective financial management, transparency and accountability. The budget is more decentralised and all spheres of government make decisions about the budget through established forums or structures. Research shows that performance budgeting has been introduced worldwide and some countries such as Australia and New Zealand have introduced it. The introduction of performance budgeting in South African Public Service is important as it introduces a results-oriented approach and encourages the management of government resources with flexibility within the legal framework so that managers remain accountable.

4.3 PUBLIC FINANCE: A THEORETICAL ANALYSIS

Public Administration is multidimensional and multidisciplinary in its approach. It's nature or approach is made up of, among others, governance, management, leadership, public policy, human resources and public finance. The latter is crucial because it supports the government's vision in attaining its goals, as it is the cornerstone of service delivery. It is because once the budget is compiled and distributed efficiently to agencies, departments are expected to ensure that strategic planning, financial planning and management, auditing, debt management, revenue management and expenditure management are central in managing public finances.

The budget becomes fundamental in financing government programmes and service delivery in general. The functioning of any government depends on proper revenue and expenditure

management. Public finances become central through regressive and progressive tax forms and other forms of financing such as borrowing in order to finance government deliverables or the implementation of public policies so that the lives of people are improved.

Herber (in Visser & Erasmus, 2002: 5) suggests that:

- a) the term *public finance* is somewhat of a misnomer for the subject matter at hand; and
- b) finance implies monetary flows as activities of the government's fiscal or budgetary processes as they progress.

The above indicates that public finance as a resource is crucial for financing government activities. Within public finance, the budget is utilised and indicates government policies, as well as financial implication of the implementation of government programmes. The government has a responsibility to provide services to people and financial management becomes critical in ensuring that quality service is provided to the people.

The budget as a fiscal policy document has to distribute and redistribute services among people. The soundness of public finance depends both upon the right policy and good organisation, but a great deal upon the latter (Sharan, 1967:344).

To understand public finance, it is important to note that it relates to the finances of the state in a multi-dimensional way because of the following factors:

- a) Public finance is manifested in the budget, which is financed mainly through taxation;
- b) Taxation implies that monies are collected from the total diversity of moneys available in a country;
- c) The use of tax income by the state results in the government being a role-player in the national economy; and
- d) Government expenditure, meaning the spending of tax income, is returned to the national economy by means of official salaries, the purchasing of stores and equipment from private companies (Visser & Erasmus, 2002: 5).

Taking into account the above factors regarding public finance makes it clear that monies to finance government programmes originate, among others, from the government tax base. It is this tax base that ensures that government delivers services to people. However, there are other avenues for the government's revenue base, like borrowing.

The plan for service delivery is mostly outlined in the country's budget. Budget as a fiscal policy, outlines and finances government projects and programmes. Therefore, fiscal policy performs specific functions in order to meet the country or government's demands.

4.3.1 Fiscal policy defined

Black, Calitz, Steenekamp and Associates (2005:266) define *fiscal policy* as national government decisions, regarding the nature, level and composition of government expenditure, taxation and borrowing, aimed at pursuing particular goals. Additionally, fiscal policy is the budgetary stance of government and is not only concerned with how much revenue is raised, but how it is raised and on what it is spent (Natrass, 1997:191).

The following is an explanation of the functions of a fiscal policy.

4.3.2 Functions of fiscal policy

Natrass (1997:191) explains that fiscal policy should perform the following three functions:

- a) provide public goods and services;
- b) redistribute resources until what is considered an equitable income distribution is achieved; and
- c) attempt to combine strong economic growth with low rates of unemployment and inflation known as allocation, distribution and stabilisation functions.

Natrass's view on budget as fiscal policy is an indication of the fact that fiscal policy plays the role of a vanguard on service delivery, is central to distribution and redistribution and ensures that there is economic stability, monitoring of inflation and reduction of unemployment.

In pursuance of government goals, Black et al., (2005:266) confirm Natrass's functions of fiscal policy, namely the goals classified as macro-goals are economic growth, job creation, price stability, balance of payments, the socially accepted distribution of income and poverty alleviation.

Natrass and Black et al., agree that in public administration, public finance in particular, fiscal policy like other components, becomes crucial in meeting government's demands and expectations.

What is critical is the fact that public finance has to be central in a country's economy and in public expenditure. In public finance expenditure, financial management becomes essential because finances have to be managed effectively to achieve government goals and vision.

Figuratively, public financial administration and its importance are described in different phrases; for example like organisation and personnel, finance is as universally involved in administration as oxygen is in the atmosphere. Secondly, the allocation of finance is the supply of fuel for the engine of administration. Finally some authors define *public finance* as the 'life-blood of government' (Sharan, 1967:343). The above figurative analysis regarding *public finance* implies that the provision of public finances to governance operations, plans and projects is central in ensuring that the government's main goal of delivering services is achieved.

Fiscal policy should therefore ensure that services to people are delivered adequately. Adequate delivery services to people should be based on adequate funding and proper budgeting and planning.

Trotman-Dickenson (in Visser & Erasmus, 2002:5) states that the economics of the public sector involves the study of public finance, government policies and the role in the industrial sector of the economy. Relating to the statement or analogy, this could suggest that understanding, both in theory and in practice, or having an academic background is crucial because it could deal with matters of national economy or public sector economics in general.

From the public financial management perspective, it is clear that public finance is connected to all the activities of government. This means that public finance is concerned with the way public authorities (central, provincial and local) finance their activities, how their expenditure is decided upon and how their revenue is obtained (Sharan, 1967:343). Sharan's view endorses the fact that public finance is the heart and cornerstone of service delivery throughout all the spheres of government.

The PFMA seeks to modernise the system of financial management and encourages managerialism in the public sector. Therefore, public sector managers have a responsibility to manage their budgets effectively so that they become accountable, responsible, transparent, with flexibility, but within a legal framework.

Additionally, evidence shows that some public finance economists do not only concern themselves with revenue and spending, but also with the views of how government should function in the economic sphere and the general attitudes with regard to a relationship between the individuals (public) and the state. The above concern by some public finance economists provide some two approaches with regard to public finance, namely:

- a) *Organic view of society*, individuals are valuable only in their contribution to the realization of social goals and the government determines the goals; and
- b) *Mechanistic view*, government is a contrivance erected to further individual goals (Rosen, 1995:4).

Based on the above, it is clear that in dealing with matters of governance, public finance in particular, the government's role and interaction within a society is crucial as government goals and objectives are attained and people's needs, poverty and unemployment are dealt with.

For example, some macro-economic and micro-economic functions of government are essential in order to understand the effect of the government in allocating resources and the distribution of income (micro-analysis); the use of taxing and taxes; spending or expenditure; and monetary policies that affect the overall level of unemployment and price levels (Rosen, 1995:4). To attend to macroeconomic and microeconomic functions of government, a budget must be in place so that services are allocated to people, tax collection and tax distribution so that the government attends to social and economic aspects. Therefore, careful structuring and formulation of the budget are crucial too attend to macro and micro economic issues and at the same time this will depend on the budgeting system of a given country.

4.4 BUDGET: CONCEPTUAL AND ANALYTICAL SYNOPSIS

The terms *Budget* and *budgeting system*, are sometimes used interchangeably, yet describe two different things serving different purposes. The use of these two terms interchangeably might cause confusion in this study. The difference between the two lies in the fact that the *budget* is process-oriented and *budgeting system* is systems-based. An analysis of *budget* as a financial planning tool to support the service delivery framework will also show how it fits in with broader governance in the public service and how it contributes to the management of

risks through the financing of other programmes within the public sector. Additionally, the budget process should provide mechanisms with regard to transparency and accountability because allocations or fiscal transfers originate from taxpayers. Therefore, the budget has to be transparent and the executive, including departmental officials, has to be accountable. What is crucial is the fact that budget and the budgeting system are interlinked in order to improve governance and service delivery in general.

By definition, a *budget* is acknowledged as a planning tool so that services are delivered effectively, efficiently and resources are used economically. Research indicates that the term *budget* is derived from a French word 'bougette' meaning a small bag or portfolio and other scholars of public finance, such as Gildenhuis who add that the term budget refers to a 'pouch' or 'purse' (in Erasmus and Visser, 1997:160). The most important aspect is that the 'bag' or 'portfolio' that carries the public finances is accountable to people for outcomes.

Regarding to the purse or pouch analogy, Wildavsky (1974:4) defines *budget* as a series of goals with 'price tags' attached to it. Wildavsky's analysis of budget could be based on the fact that governments sets up objectives or priorities in order to link policy, budgeting and planning with regard to revenue and expenditure management and to attend to the macro-economic strategy of a country.

Thus, the budget becomes a document that contains useful information with reference to government priorities, budgeting, costing of policies, expenditure and programme outputs and outcomes. This type of information is crucial in the midst of transparency and fiscal accountability, more especially for parliamentary oversight in general, the Standing Committee on Public Accounts (Scopa) in particular.

With reference to the above analysis and the budget itself, Lee Jr & Johnson (1998: 14) define budget as a document or a collection of documents that refers to the financial condition of government, including information about revenue, expenditure, activities, and purposes and goals. A budget without information relating to revenue, expenditure, activities and goals is not a comprehensive fiscal policy because of the absence of information regarding expenditure trends, and could undermine parliamentary oversight.

Lee Jr & Johnson further argue that a budget is prospective; referring to it as containing an anticipated future revenues, expenditures, and accomplishments that it contains (Lee Jr. and Johnson, 1998:16). The stating of accomplishment is crucial as it helps the public and the government to know or understand the expected outcomes of a project or programme.

What is most important within a budget as a documented policy framework of government is credibility, content and the way information is packaged so that both the inhabitants and government are able to co-assess the budget decisions or outputs through a monitoring and evaluation strategy. What is also most important is the foundation or principles with regard to the budget or budgeting system itself.

4.4.1 Budget principles

As a result, Smith (1994: 81) submits the following budget principles:

- a) **Publicity:** The main stages of the budget process, namely executive recommendation, legislative consideration and action, and budget execution, should be made public;
- b) **Clarity:** The budget should be understandable to every citizen;
- c) **Comprehensiveness:** The budget should contain expenditure and revenues on a gross basis, reflecting all governmental activities without exception;
- d) **Accuracy:** Budget estimates should be as accurate as possible and there should be no 'padding' of expenditure estimates or providing for hidden reserves by underestimating revenues; and
- e) **Periodically:** Appropriations should be authorised for a definite period of time. An appropriation not used at the end of the period should generally lapse or be re-appropriated with the specific amount and purpose detailed.

The above principles indicate that it is necessary that a budget contains the ethos of democracy and elements of good governance, such as accountability, transparency, participatory and responsiveness.

4.4.2 Role-players: budgeting process

Data shows that for an effective budget system, a participatory and inclusive approach and process are essential. This implies that role-players in the budget process must be identified so that the budget process becomes transparent. Once role-players have been identified for the budget process, the process must be within a legal framework so that budgetary systems are strengthened.

With reference to the legal framework, section 215 (1) of the Constitution of the Republic of South Africa states that national, provincial and municipal budgets and processes must promote transparency, accountability, and effective financial management of the economy, debt and the public sector. This supports and endorses the fact that a budget and its processes should be transparent in order to promote financial management in the public sector in general so that any risks originating from poor management of the economy and public sector debt are easily detected.

Additionally, section 215 (2) (c) of the Constitution of the Republic of South Africa also states that the budgets in each sphere of government must show the sources of revenue and the way in which proposed expenditure will comply with national legislation. Additionally, the foundation of a legal framework is also fundamental so that role players are able to operate within parameters to ensure compliance with regard to fiscal norms and standards. Central to the above legal requirements are the ethos of governance, fiscal accountability and revenue and expenditure management. Hence, it is vital to ensure that an inclusive approach is established in order to promote a culture of good governance and it is of paramount importance that the managerial leadership ensures that a culture of compliance with fiscal norms is institutionalised.

To this effect, matters of governance such as expenditure management, parliamentary oversight, accountability, planning and budgeting, policy prioritising and budgeting, political and managerial accountability, risk management, fiscal discipline, monitoring and evaluation should be taken into account and adhered to.

Among others, the role-players in South Africa are the national Parliament and provincial legislatures, parliamentary committees, the Cabinet, including cabinet committees, the National Treasury, the Financial Fiscal Commission and intergovernmental forums. On the

basis of the constitution, Walker and Mengistu (1999:66) provide the following diverse group of structures that are involved in the budgeting process.

4.4.2.1 Financial and Fiscal Commission (FFC)

The Constitution of the Republic of South Africa (1996) legally establishes the Financial and Fiscal Commission (FFC). To illustrate the point, sections 220 and 221 of the Constitution establish the Financial Fiscal Commission in order to provide impartial recommendations. Through the Constitution, the Fiscal and Commission Act of 1997 is established. The commission is independent in terms of sections 2 and 3 (1) and makes recommendations and gives advice to organs of state in the national, provincial and local spheres of government on financial and fiscal matters (Financial and Fiscal Commission Act, 1997: 4). In terms of the Act the commission as consultative body and advisory unit is expected to be part of the budgeting process. The commission provides advice, *inter alia*, about how government revenue should be shared among the various tiers of government, fiscal allocations, taxation, borrowing and the criteria used in determining these matters (Abedian et al., 1998:26). Thus, it is relevant and essential that the commission establishes itself within the budgeting process so that expenditure (allocations) and revenue are managed in all spheres of government. This has to be done because revenue and expenditure management are crucial in support to governance in general.

4.4.2.2 Budget Council

The Intergovernmental Relations Act No. 97 of 1997 establishes the Budget Council that consists of the National Minister and Members of the Executive Council (MEC) of Finance of each province. Financial and Fiscal Commission chairperson or a representative attends the meeting of the council.

The minister is the chairperson of the Budget Council. Section 3 of the Act makes provision for the functions of the budget council: Among others, the council consults on:

- a) fiscal, budgetary or financial matters affecting the provincial sphere of government;
- b) any matter concerning financial management, or monitoring of the finances of provinces or a specific province; and

- c) any proposed legislation or policy which has a financial implication for the provinces, or a specific province (Intergovernmental Relations Act of 1997: 2).

Most importantly, the Budget Council encourages communication between spheres of government because provinces are unique. Socio-economic and political environments mostly affect the budgeting process and those environments must be taken into account or observed in public administration in general.

What is also crucial regarding the communication between spheres of government is to encourage fiscal management regarding public finances and ensure that a culture of monitoring and evaluation of the public sector is developed.

4.4.2.3 Ministers committee on the budget

This committee involves the political level during the budget process in order to enhance budget prioritisation and policy review. Among others, the committee evaluates the output of the national medium-term expenditure committee, evaluates the MTEF review reports and makes recommendations to Cabinet on the division of revenue and the allocation of the national share between departments. In essence, the committee is also responsible for planning and expenditure management. The latter is essential in ensuring effective governance in the public sector in general because once any expenditure is poorly managed, the vision, mission and objectives of government might not be attained and that could be risky for the government, especially in relation to the electorate (Walker & Mengistu, 1999:69).

4.4.2.4 Medium-term expenditure framework committee

This is a technical committee, responsible for evaluating whether the departments and their spending plans are consistent with government objectives and are economical and equitable. Most importantly, it also has to assist in identifying the spending patterns of departments and by so doing, spending risks are identified. Without identifying and analysing such expenditure patterns it could be difficult to detect possible threats on available resources of government (Walker & Mengistu, 1999:69).

4.4.2.5 *National Treasury*

It should be noted that before the democratisation of South Africa, there has been a national Department of Finance and as well a National Department of State Expenditure. The two departments have merged to form the National Treasury. The latter has the mandate, among others, for the promotion of the national government's fiscal policy framework. It is also responsible for the co-ordination of intergovernmental financial and fiscal relations and managing of the budget process. The National Treasury also monitors the implementation of provincial budgets as per Public Finance Management Act, 1999.

4.4.2.6 *Auditor-General*

In government, the Auditor-General, in terms of Public Audit Act, No. 25 of 2004, is responsible for financial management and control in all spheres of government. The financial control happens through its auditing expenditure at all three levels of government. The main function of the Auditor-General is to ensure that correct accounting procedures and standards are followed with regard to expenditure and revenue reported. It is also stated in the Act that the Auditor-General reports to the public accounts committees, this represents a final link in the chain of accountability (Walker & Mengistu, 1999:69). Such a link is weakened by two critical factors: First, the reports become only available two years after expenditures have taken place. Secondly, inadequate mechanisms exist to take decisive action for the recovery of fraudulent or 'fruitless, unauthorised expenditure (Walker and Mengistu 1999:69). The concerns are still prevalent in the Public Service and they weaken fiscal accountability and undermine good governance.

4.5 BUDGETING AND PROCESSES

As indicated earlier in the study, budget could also be regarded as a planning tool within an organisation, especially financial planning. The following fundamental perspectives are essential so that budgeting in the public sector is placed in a particular context; for example, financial controls and systems, including accounting systems, need to be in place to ensure good governance.

The processes are:

- a) The legislature is responsible for the sanctioning of the overall public sector budget. The legislature is also responsible for authorising the executive to incur expenditure within the overall level of expenditure;
- b) Budgeting is an essential component of the financial planning, control and evaluation process of the public sector. By its nature, budget is a means of allocating resources to achieving the objectives of the public sector;
- c) It is also a management tool for planning and a means of controlling funds to ensure that the stated objectives can be met;
- d) Annual budgeting is most successful if it is linked to a medium-term framework, a plan that usually covers a period of about three to five years. The medium framework contains measurable statements of the objectives and a resource framework to plan for the period, which is revenue projection and ceiling;
- e) To be effective, a budget should be integrated with accounting. If an accounting system has been adopted for budgeting and financial reporting, it will provide a framework for accounting information. This will give a more rational basis for planning and controlling expenditure and decision-making for financing; and
- f) Regular monitoring of the budget is vital. Therefore, revenues and expenditures against budgets need to be reliable and readily available for discussion, management action and projections revised where necessary (International Federation of Accountants, 2001:47).

Budgeting within government is important because it supports government projects and programmes and it involves financial decisions so that departmental goals are achieved such as service delivery goals. These decisions should be guided by other factors or systems like accounting, financial reporting, monitoring of expenditure and fiscal accountability. Most importantly, the effective implementation of a budget depends on the budgeting system within a country.

4.6 BUDGETING AS A SYSTEM

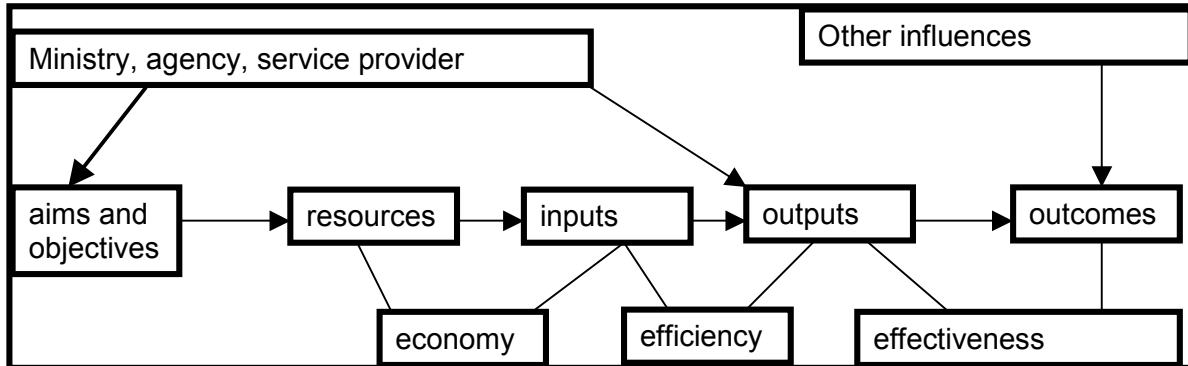
In the previous section (see section 4.4), the theory in relation to the term *budget* was discussed and analysed. Budget is based on certain principles and these principles serve as a guide to ensure that a budget is crafted by an institution and also owned by the public. Therefore, accountability and transparency are entrenched in a budget process.

The budgeting system looks at the process of implementing a particular budget; the process, institutional structures, competing norms and values, actors and relationship among each other also play a role and produce outputs (Lee Jr & Johnson, 1998:16). In addition to the above, it is evident that there is interconnectedness between components so that outputs are produced.

Budgeting as a system means a set of units with a relationship among each other. Budgetary relationships are crucial in a budgeting system, especially in terms of a complex system (Lee Jr & Johnson, 1998:16). This illustrates the relationship between a budget and its systems, especially when dealing with budgetary reforms and the complexity with regards to a budget itself. This also exemplifies a process in delivering outputs and outcomes or results based on government priorities. The performance budgeting system in South Africa emphasises outcomes rather than activities (Shall, 1999:10). What it means is that managerial leaders have a responsibility to ensure that government departments promote efficiency, effectiveness and economy (the three E's) through the application of performance budgeting or a results-oriented budgeting system. The following shows the relationship between efficiency, effectiveness and economy in order to support institutional governance in the public service and government in general. The three E's take place within the context of the NPM approach and is encouraged by the Constitution, section 195 in particular, namely that "efficient, economic and effective use of resources must be promoted". It is therefore important that managers in the Public Service deliver as planned and in time (efficiency), makes reasonable options regarding spending on the basis of value for money and within legal framework or 'do more with less' (economic) and make sure that outputs produced by a department have an impact on the public (effectiveness).

The following diagram shows such a relationship between the three E's.

Figure 4.1: Relationship between the three E's



Source: Adapted from Roberts, J. (2003:4)

Figure 4.1 suggests that a ministry or a department has objectives, aims, a vision and mission on the basis of service delivery. A department or agency must ensure that there are resources like budget and competent personnel (inputs) to deliver the outputs.

Outputs could be 20 000 000 books delivered or the same number of houses delivered. It is important that outputs delivered produce outcomes to the people (effectiveness). Therefore, managerial leadership should be able to ensure that the relationship between inputs and outputs deliver desired results to the public. In delivering the services to the public, the managerial leaders should also make sure that resources like funds are used efficiently, economical and effectively and people should also be skilful and efficient to deliver services (outputs). It is crucial that the managerial leadership ensures that departmental programmes produce results to communities, that is called 'programme effectiveness'. In support of good governance in general and public finance management system in particular, the managerial leadership should understand both external (macro) and internal (micro or institutional) environments in order to deliver services efficiently, effectively and economical.

4.6.1 MEDIUM-TERM EXPENDITURE FRAMEWORK (MTEF)

Before democratic process in South Africa, incoherent or disjointed policies, poor planning, and less linkage between a budget and planning were evident. Research shows that fiscal matters such as underspending and overspending negatively influenced service delivery strategy and policy priorities. However, issues like over pending, fruitless expenditure and

under-spending are still a matter of concern. During the 1998/1999 budgets, the MTEF was introduced as part of budget reforms in order to attend to fiscal matters raised above.

MTEF is a three-year rolling strategy, which sets up spending plans for national and provincial departments. MTEF is the basis for the budget reform initiatives that have taken place in South Africa (National Treasury, 2001:3). With regard to MTEF, the government aims to achieve the following:

- a) The MTEF aims to reinforce the link between the government's policy choices, its budget and the delivery of services. This serves to strengthen political decision-making and accountability;
- b) It is believed that policy choices and trade-offs are made explicit and spending decisions are kept affordable in the medium term; and
- c) Lastly, once the MTEF is introduced and implemented, there will be a better management of public finances (National Treasury, 2001:3).

Even before the MTEF was introduced in South Africa, some discussion and debates regarding budget reforms have been taking place, especially in the international arena. For example the United Nations Development Programme (UNDP) states the following:

- a) The introduction of the MTEF is to make public management more transparent, accountable and results-oriented; and
- b) Most importantly, the MTEF could be used as an expenditure management tool (fiscal discipline) and as a planning tool (United Nations Development Programme Report, 2003:58).

The government and UNDP's views are important as they support elements of governance, like transparency, accountability and responsiveness. It is established that in supporting the MTEF, matters such as the Medium-term delivery framework, government prioritisation and fiscal discipline are fundamental.

Walker and Mengistu (1999:31) add that the primary benefit regarding the MTEF is the ability to link budget and policy, the provision of information on the actual goods and services bought

with money allocated. As indicated earlier, a link between policy and budget is fundamental in the MTEF as it helps to deliver services effectively and efficiently.

The following are the fundamental aims with regard to the MTEF in government:

- a) **Creating certainty in the planning environment:** If forward projections of expenditures and revenues are credible, line departments may have more certainty about resources that are at their disposal in the future.
- b) **Detection of fiscal problems before they occur:** A programme may be affordable in the first few years but become totally unsustainable in the following years. Problems regarding unsustainability and affordability could be easier to foresee and manage within the MTEF.
- c) **Supporting political decision-making:** Policy and programme trade-offs may assist Cabinet in evaluating policy options and setting expenditure priorities.
- d) **Promoting sectoral planning:** Sectoral planning could assist or contribute to the achievement of common goals.
- e) **Enhancing fiscal discipline:** Medium-term fiscal plans may be used as an instrument for translating aggregate expenditure targets into allocations to line agencies and programmes (Abedian et al., 1998:135).

Regarding the above fundamental issues, it is important to note that the MTEF could serve as an 'early warning system', promotes planning and decision, and ensures discipline with regard to funds allocation.

Research has shown that for a country or government to overcome fiscal constraints that impede on accountability transparency, fiscal management and the value for money principle, budgetary reforms must be a prerequisite.

In South Africa the MTEF was introduced in 1998/99 financial years and research shows that other countries in Africa that introduced MTEF are Uganda, Tanzania, Ghana, Rwanda, Cameroon, Burkina Faso and Albania. This shows the commitment of Africa to fiscal planning and budgeting, including aiming for results not just inputs or processes. By committing to the MTEF, Ghana introduced a results-oriented management model that aimed at new management culture whereby focusing on measurable outputs and outcomes as opposed to managing processes (Kithinji & Mlambo, 2001:93). Kithinji & Mlambo (2001:93) also claim that

the MTEF is designed to impose discipline into planning and the management of public resources. The above authors indicate the importance of the MTEF in governance because the MTEF encourages transparency and accountability in the utilisation of resources, including fiscal planning and discipline. However, it is important to note that within the MTEF, policy prioritisation and budgeting are paramount because both assist in setting an agenda for government and spending departments.

4.7 POLICY PRIORITISATION AND BUDGETING

A link between government policies and budgeting is of paramount importance, especially within the culture of the medium-term expenditure framework (MTEF) and performance budgeting. The coordination between policy and budgeting assist long-term strategic planning in order to improve service delivery and foster a culture of transparency and accountability through reporting, monitoring and evaluation strategy. The co-ordination of policy and budget is critical as it is one of the fundamental reasons for introducing the MTEF in South Africa. Once policy and budget is linked. It could guard against overspending, underspending, including fruitless expenditure by the Public Service.

4.7.1 Policy and budget: A linkage

There are various reasons for effective co-ordination between budget and policy, especially for long-term policy objectives:

- a) It helps to establish a comprehensive set of goals and priorities by ensuring that policy proposals fall within set parameters;
- b) The strategic framework can be used as a tool to orient policy development in line ministries. This could involve all the ministers who will be responsible for implementation through sectoral policies;
- c) Budget plays the role of a co-ordinating tool because it affects sectoral activities and provides an annual opportunity to set political and strategic directions for the future;
- d) Through the co-ordination, budget plays a role in defining and setting up government priorities; and
- e) The co-ordination between policy and budget assists in defining relative levels of expenditure for different programmes (United Nations Development Programme, 2003:58).

Given the above reasons, the policy-budget co-ordination reduces risks that could be social (poor service delivery), economic (over spending, under spending), and political (poor or non-implementation of governments priorities, vision and mission).

In order to enhance policy integration and cohesion, Pillay (in United Nations Development Programme Report, 2003:59) explains the process of MTEF planning at Cabinet level. Among other issues, Pillay observes that from the beginning, the process involves Cabinet in order to identify strategic priorities and review progress in the past year. From February to June, Departmental business plans; MTEF and Strategic plans are developed. At the same period, directors-general clusters are also expected to finalise their programme of work and priorities for clusters, including approval by Cabinet. Around mid-year (July) cabinet reviews directors-general cluster's report on progress with priorities and action plans. From July to December, impact is measured through data collected on service delivery and later departmental annual progress review reports to the President's office.

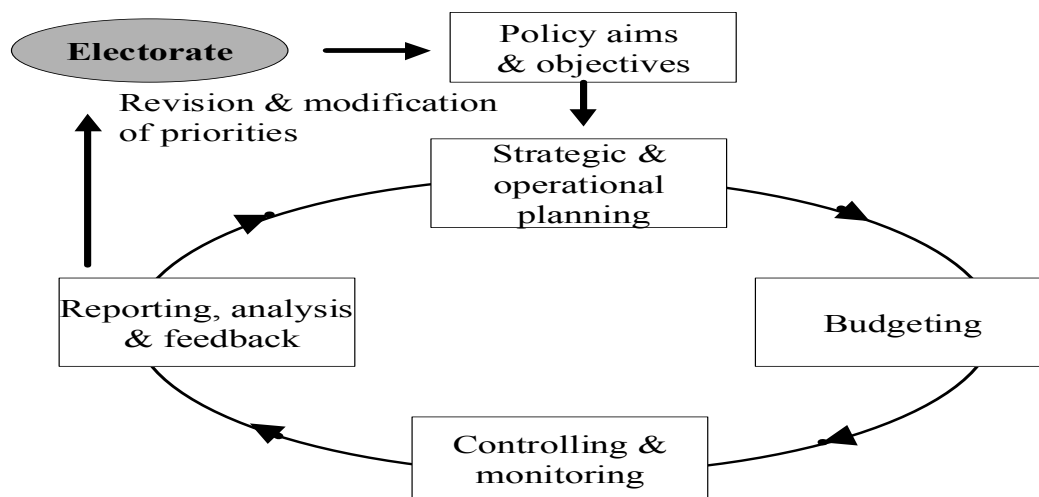
Lastly, Pillay (in United Nations Development Programme, 2003:59) also believes that central to an integrated national planning cycle is the cycle taking place within a three-year medium-term strategic framework cycle. Pillay's view regarding policy integration and cohesion is crucial especially with regard to the medium-term delivery framework (MTDF) in terms of sectoral policy priorities because it enables the government to know what is in the fiscus for service delivery. The linkage is crucial because it helps the government to cluster its programmes according to macro-economic matters affecting the population.

Once the Cabinet has completed the strategic planning, it has to filter down to departments. So the heads of departments (HoD) or the Accounting Officers (AO) have the responsibility to implement priorities set up by the Cabinet. Managers in their own departments should plan and develop control processes within an organisation.

Figure 4.2 below shows the importance of taking into account the views of people or the electorate when setting policy imperatives. The process starts by setting or formulating policy imperatives, aims and objectives. It is argued that policy outline is mostly outside management mainstream because it is a political process. What is important is the formulation of strategic planning, linking it to the budgeting process because in terms of performance budgeting, strategic planning is crucial as it has to link to the MTEF. Lastly, based on the diagram, the

controlling of funds and monitoring of the process of delivery is critical as it helps to provide a feedback to management within a department. Monitoring, feedback and internal reporting are crucial as these aspects support managerial accountability and development, effectiveness of governance and financial systems in ensuring that quality service is delivered with appropriateness.

Figure 4.2: Integrating the planning, budgeting, monitoring and reporting processes



Source: Abedian, Strachan & Ajam (1998:65)

4.8 TYPES OF BUDGETING SYSTEMS

Different governments for various reasons have used different budgeting systems. Research reveals that the introduction of a particular budgeting system is influenced by different reasons. Mostly the influence is based on the political agenda of the government, for example introducing the ethos of democracy and restructuring macro-economic trends of government as in South Africa. Therefore, some budgeting systems improve or undermine accounting and auditing standards, fiscal management and elements of good governance, like transparency and accountability. Lastly, it has been noticed that some budgeting systems focus more on ‘administration and control’ of public funds than on the management of public funds. Discussing and analysing the different types of budgeting systems are important as it helps to

understand the budgeting process and its systems, and the impact on financial management and governance in general.

Henry (1980:208-225) provides the following opinions regarding budgeting systems:

4.8.1 Line item budgeting

- a) Line-item budgeting is associated with, among other things, honesty, efficiency, less propitious attitudes and inflexibility.
- b) Line-item budgeting uses phrases like ‘watchdog of the Treasury and balanced budget’ and emphasises factors like skilled accountancy and dispersed responsibility for management, planning and the fiduciary role for budgeting.
- c) Line-item budgeting focuses on inputs only meaning that this budgeting system concerns or deals only with what will make the project continue.

Previously, South Africa has been using the line-item budgeting system. However, the criticism has been about its focus on inputs or an internal process rather than results or outcomes. As a result, the performance budgeting system replaced the line-item budgeting system.

4.8.2 Planning, programming and budgeting (PPB)

It is argued that planning programme budgeting (PPB) is associated with budget officers who have skills in economic analysis, as well as in accountancy and administration. Decision-making becomes less incremental and more systematic throughout bureaucracy. Management responsibility becomes more supervisory in nature, while planning responsibility becomes increasingly centralised. PPB is concerned not only with inputs and outputs, but also with ‘effectiveness and alternatives’ (Henry, 1980:213). Regarding Henry’s argument it is deduced that PPB involves a cost benefit analysis (CBA) to make effective financial decisions. This analysis is fundamental in public finance, governance in particular. PPB has the following characteristics:

- a) It is an effort to integrate budgeting formulation with Keynesian economic concepts, as it attempts to consider the effects of government spending on the national economy;

- b) PPB is an effort to develop and use new information sources and technologies to bring more objective and qualitative analysis to public policy-making; and
- c) PPB is an effort to integrate systems-wide planning with budgeting.

Referring to the last point, PPB is recommended for the ability to integrate planning with budgeting. However, it becomes a challenge for some departments (Henry, 1980:213).

On the disadvantage perspective, it is noticed that PPB stresses planning, goal clarification and systematic and scientific decision-making trends to force decisions up the hierarchy (Henry, 1980:21). This could have a negative impact on governance and financial management in general; once organisational decisions are not decentralized, governance could be undermined.

4.8.3 Management by objectives

Within the context of management, Drucker (in Henry, 1980:219) defines management by objectives (MBO) as a process whereby organisational goal and objectives are set through the participation of organisational goals members in terms of results expected. From the definition, it is clear that MBO is participative in approach in order to achieve results.

It is argued that MBO is the process of goal-setting between a supervisor and subordinate to establish performance goals linked to organisational objectives. The genesis of MBO is a management strategy rather than a budgeting technique (Walker & Mengistu, 1999:17). Walker & Mengistu's criticism reveals that MBO could prove more useful in setting organisational strategy, mission and vision rather than linking the former to budgeting and financial management.

To sum up, MBO is an attempt to set up objectives, track the progress of the appropriate programme, and evaluate its results. It is also concerned with inputs, outputs, and effects but not with alternatives (Henry, 1980:220). From Henry's argument it is clear that MBO is able to track progress and results based on the managerial decisions taken or inputs, but it is evident that MBO is not flexible due to socio-economic factors that might emerge. Hence MBO does not take alternatives. It is also noticeable that MBO is compatible with other budgeting systems like performance budgeting because it also aims for targets through participatory

approach or dialogue with managers. What is also featured is the ability of the MBO as a system to track the progress of various programmes within an organisation. This is fundamental for performance budgeting system in South Africa. In essence, MBO also provides performance information to support elements of good governance such as accountability and transparency.

4.8.4 Zero-based budgeting

In essence, zero-based budgeting (ZBB) has the following characteristics:

- a) It considers inputs, outputs, effects and alternatives, and focuses on the decision-making process;
- b) It demands managerial and planning skills for its personnel; and
- c) In contrast, it tends to grossly overestimate an administration's capacity to calculate program effectiveness, and vastly underestimates the importance of political and technological constraints (Henry, 1980:223-225).

On the basis of the above, ZBB is believed to be taking care of the fundamental aspects of a budgeting system like inputs, output and outcome or effects, but underestimating political aspects could be detrimental because an involvement of a political arm or cabinet is important.

4.8.5 Performance Budgeting

Evidence shows that there is an international trend, both in African countries and the Organisation for Economic Co-operation and Development (OECD), on the use of performance budgeting within the context of the medium-term expenditure framework. Performance budgeting provides a results-oriented approach as opposed to an input approach by line-item budgeting.

Figure 4.3 demonstrates that the new budgetary system, namely performance budget system, shows that the MTEF, the PFMA and the South African Constitution of 1996 are embedded or form the basis of the performance budgeting system in South Africa. Due to the culture of public financial management and planning, good governance, accountability, transparency, policy prioritising, policy and budgeting are captured in the country's budgetary reforms.

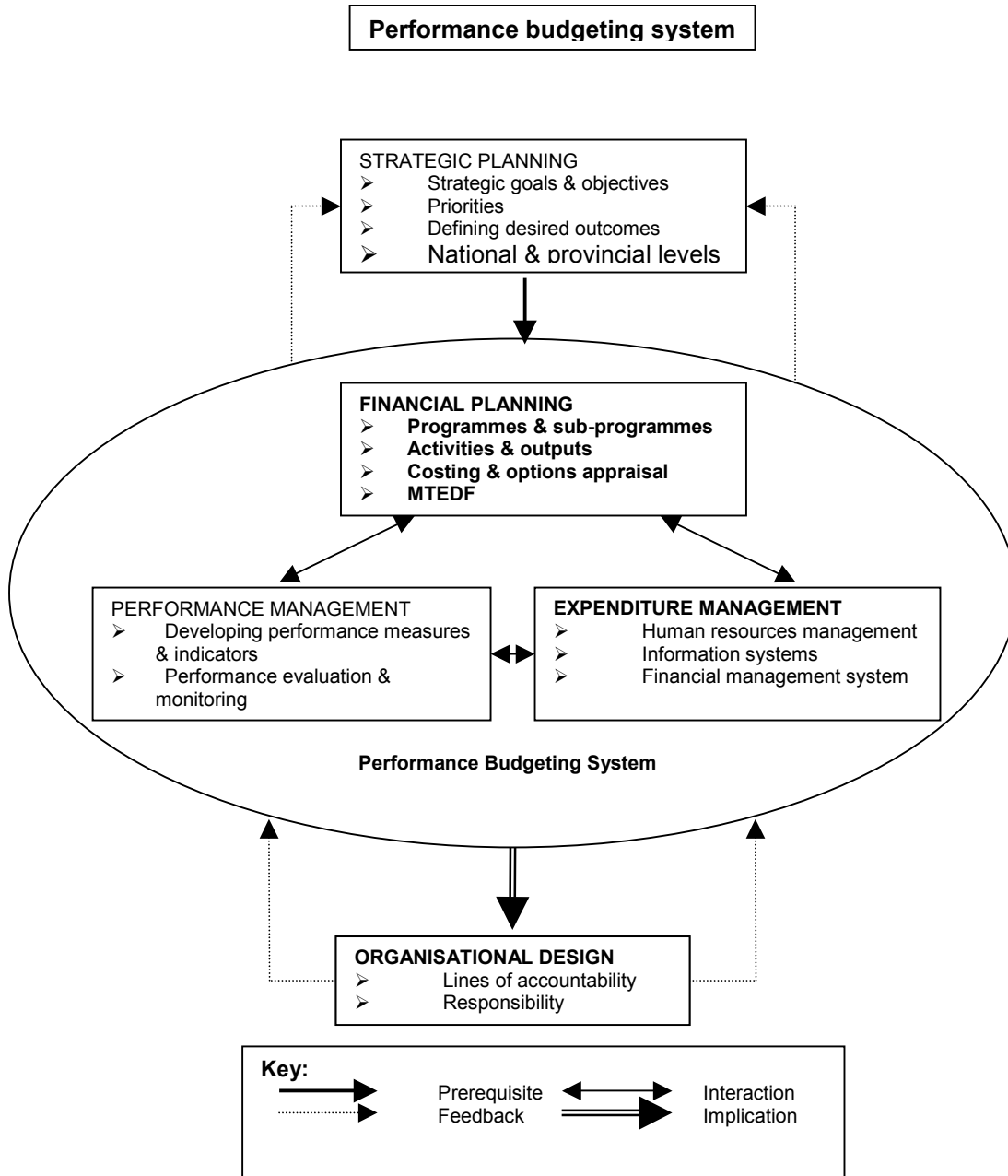
As indicated earlier, a performance budgeting system has a results-oriented approach as opposed to a line-item budgeting system, which is only input oriented, or about inflow and the outflow of public monies. Based on the figure, it is evident that strategic planning is fundamental in order to set strategic goals, encouraging setting up priorities and defining an expected outcome. The cabinet defines expected outcomes both at provincial and national spheres of government.

The figure indicates that in a budgeting system, strategic planning is a precondition for financial planning, which, in turn, outlines activities and outputs of a given department or an entity. It also indicates that Medium Term Expenditure Delivery Framework (MTEDF) falls within financial planning. It is in this context the accounting officer of a department, in terms of the PFMA, is responsible for outputs. Based on the figure, it is also apparent that financial management must interact with performance management and expenditure management in order to support strategic organisational goals and objectives.

Consequently, performance indicators and measures, performance evaluation and monitoring, information systems and human resources, especially, financial management skills, can support governance in the Public Service. What is of vital importance is that financial planning with regard to activities and outputs, costing appraisals and the MTEDF can be used as a feed back to the strategic planning of the national and provincial spheres.

As much as it encourages transparency and accountability *per se*, the lines of the same accountability and responsibility are clarified. For example, section 38 of the PFMA clearly outlines lines of responsibility and also the lines of accountability, especially both for internal and external reporting.

Figure 4.3: Performance budgeting system



Source: Shall (1999: 12)

In terms of the system's theory described in the preceding chapters, budgeting as a system fits well. Therefore, performance budgeting could be described as a 'system' of budgeting which attempts to integrate the process of strategic planning, financial planning and performance management. Furthermore, what is most crucial is that a *system* focuses on outcomes rather than activities (Shall, 1999:10). It is because focusing on activities has been a traditional form of budgeting system that has resulted in an input-oriented budgeting system.

Walker & Mengistu (1999:15) also note that:

- a) Performance budgeting provides information on accountability and efficiency for each responsibility centre.
- b) The control thrust of a performance budget is to arrive at a performance target.

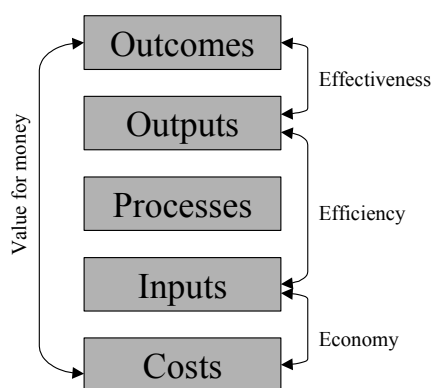
Mengistu & Walker's comments with regard to the performance budgeting system confirm that the budgeting system has elements of accountability, targets for efficiency and effectiveness and is a results-oriented budgeting system. Central to their comments are matters relating to information on accountability, efficiency and performance targets which are important in the modern public management. The forthcoming model on outcome-focused management and budget model sets the tone for the new public management entrenched in the South African Constitution of 1996 and the PMFA. Therefore, the performance budgeting system as embedded in the latter contains sentiments that are outlined in the model. As indicated earlier, the Performance Budgeting system emphasizes the correct use of funds efficiently and effectively, more importantly the economic use of resources during the process of service delivery.

Therefore, the efficiency, effectiveness and economic approach or the three E's put more emphasis on the value for money. The process from input (costs and human resources base) to evaluation of outcomes assists in ensuring that services delivered are value for money. The outcomes-based model or results-based approach is reflected on the Figure 4.4. The model shows a linkage between input-output-outcome to be crucial in service delivery, especially when the MTDf has been finalised and adopted at a strategic level. The model also shows that decisiveness or ability to look for alternatives for the economic use of resources is a process that is efficient so that outcomes (effectiveness) or results are achieved as planned. Within this context the efficient, economic and effective use of resources become one of the basic values and principles governing public administration in South Africa (Constitution of the

Republic of South Africa, 1996:107). Figure 4.9 below also shows the context in which performance budgeting is applied. As indicated earlier in the text that performance budgeting promotes value for money and is outcome or results-based. It becomes a responsibility of the managerial leadership in the Public Service to institutionalise outcomes-based management and budgeting, performance budgeting systems in this instance.

4.9 OUTCOMES-BASED MANAGEMENT AND BUDGETING MODEL

Figure 4.4: Link between inputs, outputs and outcomes



Source: Organisation for Economic Co-operation and Development (2002:9)

After discussion of the term ‘*budget*’ and the different budgeting systems and their effects on public administration, these are shown in table 4.1 with a brief outline of their features, focus or objectives, scope, skills needed to implement a particular budgeting system and the role of a budgeting agency. What is most important is the fact that each budgeting system that is likely to be used or already in use in a particular country has to be analysed or scrutinised in order to execute it effectively; that is, its prospects and consequences have to be examined.

As a result, table 4.1 reflects a matrix or an integrated analysis of the features of the different budgeting systems, especially their impact on organisational ingredients like decision-making, planning, management and decentralisation. On the other hand, the table illustrates some technical skills needed in ensuring that a particular budget is implemented effectively and efficiently. The proficiency in implementing a budget or other programmes is vital in order to deliver on strategic objectives. It is therefore a challenge for officials implementing government programmes such as performance budgeting system that is currently used in the South

African Public Service to be well skilled in order to attend to matters relating to under spending, strategic planning, fruitless expenditure and the ability to link budgeting and planning. It is because, in most cases, personnel skills are affected by a change in the environment, namely in the technological, economic, social or political environment. Therefore, it becomes necessary to upgrade personnel skills in order to guard against the pressure by an environment.

Furthermore, the political, economic, technological and social aspects of the macro environment influence the micro or institutional environment. Hence, it is paramount that institutional or organisational environment is able to sustain external pressures. However, ignoring an environment is not an option in social sciences. What is also important is the ability of the leadership to understand and support public service reforms, particularly the results-oriented approach in budgeting. For example, Perrin (2002:3) suggests that in managing government reforms or initiatives the leadership should take various forms, including top level for a results-focused approach, capacity building, and effective communication. Perrin (2002) also recommends that proponents of results-focused management and budgeting need to lead by example, in particular by undertaking an independent evaluation of reform initiatives. Perrin supports an evolving public finance management system, and states that leadership in general, the managerial component in particular, should manage transformation so that good governance becomes the culture of the Public Service. However, the managerial leaders should be skilful both technically and conceptually in ensuring that public finance reforms are implemented, particularly the results-based management and budgeting. It is also important that once a budgeting system is implemented, the environment becomes central in order to attend to pressures on organisations.

Table 4.1: Features of budgeting systems

Feature	Line-item budgeting	Performance budgeting	Planning-program-budget	Management by objectives	Zero-based-budgeting
Basic Orientation	Control	Management	Planning	Management	Decision-making
Scope	Inputs	Inputs, outputs, effects, and alternatives	Inputs, outputs, effects and alternatives	Inputs, outputs, and effects	Inputs, outputs, effects, and alternatives

Feature	Line-item budgeting	Performance budgeting	Planning-program-budget	Management by objectives	Zero-based-budgeting
Personnel skills	Accounting	Management	Economics and planning	Managerial 'common sense'	Management and planning
Critical information	Objectives of expenditure	Activities of agency	Purposes of agency	Programme effectiveness	Purposes of program or agency
Policy-making style	Incremental	Incremental	Systemic	Decentralised and participatory	Cautiously systemic
Planning responsibility	Largely absent	Dispersed	Central	Comprehensive, but allocated	Decentralised
Role of the budget agency	Fiscal propriety	Efficiency	Policy	Programme effectiveness and efficiency	Policy prioritisation

Source: Adapted from Henry, (1980:226)

Apart from the performance-based budgeting system, the government also introduced the new economic reporting format (NERF) in the Public Service. Introduction of the NERF is crucial and central to the introduction of the new Standard Chart of Accounts (SCoA) to be implemented in the financial systems (National Treasury, 2003:1). The introduction of SCoA also implements section 216 of the Constitution, namely “national legislation must establish a National Treasury and prescribe measures to ensure both transparency and expenditure control in each sphere of government, by introducing uniform expenditure classifications”. The introduction of NERF and SCoA in particular implements constitutional provisions and improves the financial systems in the Public Service and governance.

Additionally, the introduction of NERF ensures that South Africa is in line with international standards and the requirements of the Government Finance Statistics (GFS) classification developed by the International Monetary Fund (IMF), as well as the requirements of the Special Data Dissemination Standard (SDDS). The latter is the minimum reporting standard set by the IMF to which South Africa is a signatory (National Treasury, 2003:2). In this context an environment, both political and economical, influences governance in particular, public

finance management systems in general. Therefore, managerial leadership has the responsibility to analyse the above environmental situations because they have impact on a number of factors such as budgeting, expenditure, quality of financial information and financial accountability and reporting. These aforementioned factors are central in ensuring that there is good governance in the Public Service and improving the public finance management system in general. The SCoA seeks to ensure that financial systems have quality information with standard classification of items so that quality information is produced for reporting; transparency and accountability are also improved. In support and improvement of governance in the Public Service, SCoA's positive contribution is as follows:

- a) It strives towards greater transparency for both reporting and comparative analysis purposes;
- b) It facilitates a standardised process for transacting in all national and provincial departments in order to improve the mobility of finance personnel between various departments;
- c) It facilitates the automated production of financial statements and other reporting information; and
- d) Most importantly, it maintains a 'single version of truth' for all reports, in that the various financial systems used by different national and provincial departments will have the same basis for data classification, ensuring consistency in the financial reporting dissemination into the public domain (New Economic Reporting Format, 2003:13).

The above analysis and advantages of SCoA indicate a step towards improving budgeting and the classification of information within departments and the Public Service in general. What is also important is the fact that SCoA creates an environment where expenditure will be explicitly justified and ambiguity will be avoided with regard to item classification within a department. The introduction of SCoA could also assist in useful information regarding assets and liabilities, which is usually contained in the financial statements. Therefore, SCoA is indeed another vehicle towards good governance and in support of performance budgeting. However, SCoA should adhere to the generally recognised applied practice (GRAP) and accrual accounting systems, which are both discussed in detail in chapter 6.

4.10 FINANCIAL MANAGEMENT: AN ANALYSIS

Financial management is not a ‘once-off’ matter, it is a course of action that is supposed to take place throughout the financial year or it is a continuous process both in government in general or departments in particular. Most significantly, financial management takes place within a particular framework or principles. The World Bank (2005:1) argues that a good public financial management (PFM) system is essential for the implementation of policies and the achievement of developmental objectives by supporting aggregate fiscal discipline, strategic allocation of resources and efficient service delivery.

Table 4.2 below explains that financial management is a multidimensional aspect; among others it involves cash management, procurement and revenue management.

Table 4.2: Financial management: a matrix

PLANNING	MANAGEMENT	CONTROL
Cost-benefit analysis (CBA)	Cash management	Accounting
Cost-effectiveness analysis (CEA)	Procurement	Financial performance auditing
Option analysis	Revenue administration	-

Source: Abedian, Strachan & Ajam (1998:48)

With regard to the PFMA, financial management is central to improving governance in the Public Service. As pointed out earlier, in its approach and objectives, the PFMA seeks to ensure that financial management becomes central in the Public Service. In the shift from traditional public administration to public management, the latter is crucial in modern public management because it is results-oriented. The PFMA is in line with the ‘new management model’ that is results oriented. The government defines financial management within the context of a results-based model.

The government, the National Treasury in particular, believes that to improve governance in the Public Service, it has to adhere to a results-oriented approach in financial management, namely:

- a) Accounting officers enter into an employment contract with executive authorities supported by performance agreements that include performance standards;
- b) The responsibility of the accounting officer and other role-players should be clearly defined for resources committed and outputs produced;
- c) There should a greater alignment of planning and budgeting processes.
- d) Strategic planning should be introduced;
- e) Accounting officers should be allowed to be flexible in the use of resources;
- f) There should be appropriate internal control, and risk management principles should be followed; and
- g) Accounting principles should be followed, like accrual accounting (National Treasury, s.a. 3).

4.10.1 Elements of financial management

In insuring good governance and public financial management system in the Public Service, certain elements are critical to note, these are:

- a) accounting system, including form of accounts, and accounting classification;
- b) budgetary and expenditure control;
- c) financial planning and reporting;
- d) management of assets and liabilities;
- e) financial control, particularly payroll control; and
- f) procurement policy (Presidential Review Commission, 1998:153).

These elements of financial management suggest that managerial leadership has to understand how to apply them within respective government departments in order to improve the public financial managerial system in general, governance in particular.

4.10.2 Fundamental prerequisites for effecting budgeting and financial management

In public administration, public finance in particular, the PFMA is crucial in ensuring that there is full adherence to or compliance with the rule of law. Financial management ensures that funds are used according to a vote granted. Financial audit, and the proper use of accounting procedures and fiscal accountability are important in financial management.

For effective financial management and budgeting, the following components are fundamental:

- a) *Rule of law*: Budgets are adopted by duly constituted authorities, for example legislatures, Parliament and a council or councils;
- b) *Budget adherence*: Once agreed to, spending and revenue plans are assumed to be carried out as enacted. If remade, the same legitimate authorities that made them in the first place should revise them;
- c) *Transparency*: The government should make information about the budget available to the public. Additionally, there should be a free press that has access to information on government resources;
- d) *Publicly expressed preferences*: The government should have the capability of collecting information on the preferences of the electorate. In the absence of reasonable information on preferences, it is difficult to allocate resources efficiently;
- e) *Avoidance of structural deficits*: Over a number of years, the budget should bring in sufficient revenue to match expenditures. This view recognises that budgeting is a long-term plan rather than a single-year proposition. It becomes a concern if government uses non-recurring revenue (transfers from other funds, short term borrowing) to finance continuing expenditure;
- f) *Timely budget adoption*: Adherence to budget timetables can be an important contributor to effective financial management and government performance. The failure to adopt budgets by the start of the financial year creates uncertainty and therefore may promote inefficiency;
- g) *Forecasting competency and predictability*: Revenue and expenditure need to be estimated accurately. If revenue is chronically estimated or expenditure is underestimated, mid-year corrections are often necessary. This compromises the ability of programme managers and other recipients of government funds to have predictable funding flows;

- h) *An operational/workable accounting system*: At a minimum, a government or government agency should have the ability to establish how much money is available and how much has been spent; and
- i) *Audit capacity*: Governments should have the capacity to ensure accountability through effective auditing. First, a 'pre-audit' capacity should exist. This has to do with controls and pre-planning on expenditures to guard against overspending. Secondly, 'post-audit' capacity should be present and governments should know, after the fact, what money was spent for and perhaps, what was obtained as a result of that spending (Peters & Pierre, 2003: 405).

The above components are crucial as they set the correct tone for budgeting and financial management in the public sector. They instil a culture of fiscal discipline, financial planning and respecting of the rule of law. These also ensure that institutions authorising expenditure, such as legislatures, are respected in terms of their legal mandate.

Based on the above, effective financial management could depend on the type of budgeting system and accounting procedures. For example, in some OECD countries, including South Africa there is a gradual and steady shift from a cash accounting system towards an accrual system of accounting. In an accrual system, the form of budgeting and financial management, such as proper financial techniques, accounting systems and proper asset management is crucial and has to be implemented or applied contextually.

More importantly, policy in general and the budget itself as a policy document are not static; both have to be contextually placed to ensure effective and sustainable application. As indicated earlier with regard to theory and practice, in some cases theory is not necessarily a challenge but its application is. The same analogy of administrative theory applies to budgeting and financial management so that elements applicable to budgeting and financial management are applied correctly.

Like other fields of study, financial management is based on fundamental principles. These principles set the tone and basis of financial management in a democratic state; South Africa is no exception.

4.10.3 Principles of public finance management

Gildenhuys (1993:54) states that financial management is based on certain fundamental democratic values serving as principles in public financial management. Some of these principles are:

- a) Public financial decisions should always aim at a reasonable and equitable manner in which public financial resources can be allocated, as well as at the most effective and efficient way;
- b) Utilisation of public financial resources must satisfy the collective needs of people optimally;
- c) The tax burden must be distributed reasonably and equitably;
- d) The elected political representatives should be responsible and accountable and responsible to the taxpayers for the collection and spending of taxes and income;
- e) With regard to sensitivity and responsiveness, political representatives must be sensitive to and respond to the collective needs of the community;
- f) In satisfying collective needs, the executive authority's responsibilities are to ensure that a programme has been executed effectively and efficiently; and
- g) It is said that all activities regarding financial management and administration must take place in public, and not under cover in secrecy or so-called confidentiality. This principle applies to the openness of financial transactions.

The above principles intend to inculcate a 'financial management culture' that focuses on effective and efficient use of government resources, reasonable and equitable financial management decision-making, equitable and reasonable tax distribution, political accountability and responsibility of tax administration and expenditure trends, efficiency and effectiveness in programme execution and transparency in financial matters, including financial transactions. The aforementioned fundamental financial matters will ensure a sound financial management culture restoring effective governance in the Public Service. Thus, the Public Service should apply financial principles in conducting its financial matters.

The following subsequent issues are also fundamental to financial management:

- a) It is important to oversee and monitor effective and efficient financial management in the public sector;

- b) The objective of a financial management system in the public sector is to support management in their deployment of limited resources with the purpose of ensuring economy and efficiency in the delivery of outputs;
- c) Financial management embraces daily cash management as well as the formulation of medium and long-term financial objectives, policies and strategies, in support of the operational plan;
- d) Financial management supervises the supporting financial and management accounting functions, and the internal control environment, as well as supporting financial systems; and
- e) Financial management is of a higher standard when it has strong high level support, complemented by a strategy of management for results instead of management for compliance (International Federation of Accountants, 2001: 48).

With regard to the last point regarding 'management for results instead of management for compliance', it is observable in the South African Public Service where departments focus on spending without planning because they fear unspent funds will be returned to the National Treasury. The concern for certain managers is to comply with the National Treasury prescripts, not aiming to get results out of spending. The habit is sometimes called 'fiscal dumping' because public funds have just been 'spent' without any form of a plan, so it has been 'dumped'. This state of affairs undermines financial management.

4.11 PROCUREMENT AND ITS EVOLUTION

4.11.1 Supply chain management (SCM) as an integral part of financial management

With regard to procurement in South Africa, there are enabling legislative frameworks that seek to ensure that services are provided through procurement and are of value for money. The process adheres to elements of good governance like accountability and responsibility, including fairness and transparency.

Most importantly is that procurement is done within the broader framework of the government financial management agenda, not just as an isolated exercise for financial or procurement officers within a department. Procurement procedures must be followed and departments must adhere to such procedures, and public money should not to be wasted due to non-

compliance to procurement policies and procedures. Non-compliance could result in a financial burden for government and financial management could also be negatively affected. Procurement has been criticised by general public and bidders. Some criticism is that procurement procedures and processes are tedious and bureaucratic, with unclear responsibilities and levels of accountability, value for money is in most cases undermined or not evaluated, and corruption is prevalent or reported in most cases.

To accomplish its tasks of ensuring uniform standards in procurement, in the 2001/2 financial year, the National Treasury embarked on a Country Procurement Assessment Review (CPAR) with the World Bank. One of the issues raised in terms of CPAR was a need to monitor value for money assessment and to replace the outdated and inefficient procurement and provisioning in government with the Supply Chain Management (SCM) function. Additionally, on the basis of the above state of affairs, the CPAR was of the view that the issues raised above should be fully integrated within financial management processes in government (National Treasury, 2003:2).

On the basis of the above, the government took a firm stand by transforming procurement in South Africa by benchmarking on international standards so that the broader financial management in government is improved. Subsequently, procurement in South Africa has shifted towards SCM. The government views SCM as an integral part of financial management that seeks to introduce internationally accepted best principles (National Treasury, 2003:2).

SCM has to play a significant role in financial management, however, to impact positively and valuably, certain essentials have to be taken into account, because it is believed that to improve financial management and monitor value for money, the following aspects are fundamental:

- a) promotion of uniformity regarding procurement;
- b) devolution of responsibilities and promotion of accountability for procurement –related functions to accounting officers;
- c) replacing outdated provision and outdated procurement with SCM has been one of government's priorities for the public sector in general (National Treasury, 2003:2).

At some level, procurement is also faced with policy-related problems, particularly policy compliance and with regard to procurement itself; the procedure towards tender approval has been tedious and fragmented. In some situations, value for money is undermined. Elements of corruption and fraud are evident through financial misconduct cases that seem to be a problem in the Public Service.

Within the context of SCM, the procuring of services takes place in a well-established ethical environment. Since the devolution of powers to departments regarding procurement, departments are unable to manage such a form of transformation due to lack of skills on procurement. Procurement is a technical process. In some situations some departments are unable to formulate a policy due to the technicality of procurement. The new approach of SCM might be too complicated for some departments, particularly at the implementation stage. The diagram outlining the new approach is attached as Annexure A. The diagram shows the elements of the SCM.

Regarding the introduction of SCM in the Public Service, the departments are expected to do the following:

- a) The accounting officer or accounting authority of an institution to which these regulations apply must establish a separate SCM unit within the unit of the chief financial officer (CFO) to implement the institution's SCM system; and
- b) An official in the SCM unit who becomes aware of a breach of failure to comply with any aspect of the SCM system must immediately report the breach of failure to the accounting officer or accounting authority, in writing (National Treasury, 2003:2).

To implement SCM requirements, the CFO is charged with the responsibility to establish a SCM unit in her or his office so that financial management is promoted. A diagram showing how the CFO's office should be established as a unit is attached as Annexure B.

4.11.2 Pillars for procurement

4.11.2.1 Value for money

On the above pillar, it is imperative that a department is able to justify a procurement outcome. The latter is significant because the best value for money should indicate if all relevant costs

and benefits over the procurement cycle are considered. The procurement function itself must provide value for money and must be cost-effective. Procurement organisations should avoid any unnecessary delays and costs for themselves or suppliers. To adhere to the value for money principle, individual departments should also ensure continuous improvement of the efficiency of internal processes and systems.

4.11.2.2 Open and effective completion

A framework of procurement laws, policies, practices and procedures must be transparent, that is, they must be readily accessible to all parties. The procurement process must be open and encourage effective competition and observance of the provisions of the Preferential Procurement Policy Framework Act (PPPFA).

4.11.2.3 Ethics and fair dealing

In procurement all parties should comply with ethical standards and deal with each other on a basis of mutual trust and respect and conduct their business fairly, reasonably and with integrity. Procurement staff is expected to recognise and deal with a conflict of interest or the potential thereof. The staff should deal with suppliers even-handedly, this means that there should be no bias. They should not compromise the state through acceptance of gifts. The procurement staff should also assist in the elimination of fraud and corruption.

4.11.2.4 Accountability and reporting

- a) This means that individuals handling procurement, as well as organisations are answerable for their plans, action and outcomes. Openness and transparency in administration, by external scrutiny through public reporting, is an essential element of accountability.

4.11.2.5 Equity

Within the context of these procurement guidelines, *equity* means the application and observance of government policies that are designed to advance persons previously disadvantaged by unfair discrimination. Within the South African context, the pillar is relevant

because of apartheid systems prior to 1994. The above pillar also encourages advancement of small, medium and micro enterprises (SMMEs) and historically disadvantaged individuals (HDI's). Therefore, HDIs and SMMEs are able to play a critical role in the economy of the country. To effect participation of SMMEs, the government has implemented the PPPFA as the foundation on which all procurement activities are based. The government declares that no public procurement system should be operated if it is not founded on this pillar (National Treasury, s.a.).

In terms of the above pillars, it is evident that procurement in particular should support or be in line with good governance and be able to manage procurement risks. Failure to set up systems or controls of procurement could result in enormous procurement risks. Additionally, they should be clear, enabling a legislative framework so that well-skilled personnel manage procurement properly.

4.12 FINANCIAL MANAGEMENT AS A SYSTEM

To ensure that standard financial decisions are made, a financial management system becomes a source of financial information so that financial management or expenditure management, including risk management, is properly managed in order to improve good governance in the South African Public Service.

Operationally, a financial management system (FMS) assists departments in ensuring that expenditure patterns in relation to its programmes and projects are done within a budgeted vote, information about the financial stand of a department is known and could be monitored. Abedian et al., (1998:140) argue that at operational level the spending is accounted for through a financial management system (FMS) as a computerised accounting system. Additionally, the FMS also aims to facilitate expenditure management as well as other aspects of financial management such as providing budgetary information (Visser & Erasmus, 2002:10). To draw a synergy between the arguments by the former and latter authors, it is noticeable that FMS serves as a financial information tool so that critical financial decisions are made in relation to expenditure and the management of public finances.

To put FMS into operation, standardised procedures should be established, for example standardised forms are used for internal charges, receipts, petty cash, general payments,

electronic fund transfers and periodic payments (Visser & Erasmus, 2002:11). More importantly, FMS does not only record transactions for accounting purposes, but it is a valuable instrument for fund management because FMS provides a regular updated record of spending patterns through which the following are determined:

- a) Spending to date compared to the budget;
- b) Current expenditure and future commitments compared to the budget;
- c) Deviations from the budget; and
- d) Increased and / or decreased spending (Visser and Erasmus, 2002:11).

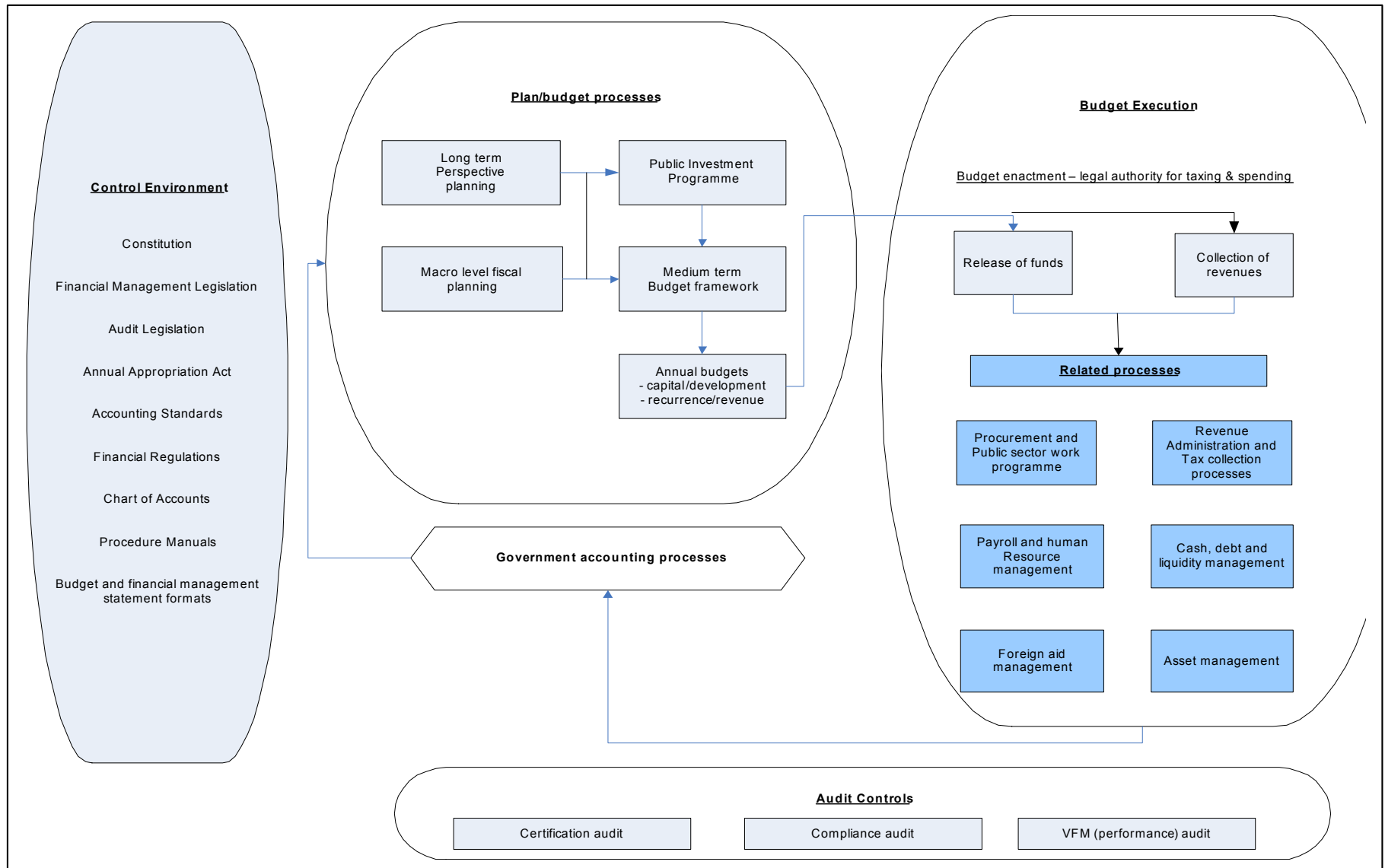
The above statement by Visser & Erasmus signals the fact FMS is crucial in ensuring that spending is done according to an approved budget, this means that expenditure trends are monitored so that deviations are reported. In this instance, matters relating to underspending and overspending, could be detected if early warnings are functional. The National Treasury has a FMS referred to as Vulindlela, which has financial information that could assist departments in carrying out their mandates and also understand the expenditure trends. In essence, Vulindlela collects and manage data to deliver useful, integrated information in order to support financial management in government (National Treasury, 2006:1).

4.13 INTEGRATED FINANCIAL MANAGEMENT SYSTEM

Having outlined issues relating to public finance and financial management, it is also imperative that an integrated financial management system is highly essential in the Public Service and systems are sometimes not linked to each other in some departments. An integrated financial management system improves governance and provides valuable information for decision-making. Figure 4.5 explains that financial systems could easily be affected if a control environment is not created. An effective integrated financial system needs a control environment. In this case the South African constitution, 1996 and the PFMA are fundamental in ensuring that effective systems are in place. An integrated approach could only be effective if departments have the ability to understand, analyse & implement the PFMA, the Public Audit Act (PAA) of 2004 and accounting standards. Most importantly, the budget, systems, financial and non-financial information are fundamental in ensuring that an integrated financial system is in place, functional and complement with other systems within a department.

Accounting processes should be integrated into the planning of a budget by government. A value for money (VFM) is fundamental in financial management, as well as the correct application of the three E's by the managerial leadership in the Public Service. To effect an integrated financial management system, especially in the South African Public Service, control environment should be taken into account, that is the Constitution, PFMA, PAA, annual budget, accounting standards, National Treasury regulations, SCoA, procedure manual and formats for budget and financial management statement formats. Figure 4.5 shows an integrated approach to a financial management system in order to promote governance in the Public Service and the managerial leadership to support the system.

Figure 4.5: An integrated approach to a financial management system



Source: United Nations Development Programme (2001:14)

4.14 CONCLUSION

The public finance management system in South Africa, the Public Service in particular, influences the ability of the leadership to manage such change. The introduction of the MTEF, a shift from the line-item-budgeting system towards performance budgeting system, the introduction of PFMA and Treasury regulations, as well as the Constitution itself have made and are still making a significant improvement in the Public Finance Management System in the South African Public Service. These significant changes also impact on spending agencies or departments whether their institutional environment accommodates or adapt to those changes, more especially in relation to a balance between the transforming public finance management system and the skills profile of the public servants in general, managerial leadership in particular. What is important is the inclusive participation of role-players in the budgeting process so that both the ministries (executing authority) and head of departments (accounting officers) have a shared vision in ensuring that services are delivered to people through linking budget to the policies and priorities of government.

The public finance management system in South Africa has introduced a culture of risk management in the public sector in general, the Public Service in particular, especially the PFMA. The following chapter explains risk management, its processes, how risk should be managed in the Public Service and the legal mandates regarding risk management. Risk management as an element of governance is discussed broadly because the aim is to provide a multidimensional or integrated approach in managing risks in the Public Service. Public administration operates within a political, social and economic environment and such dimensions affect an institution or a department, including service delivery in general. Risk management and internal controls are seen as crucial in ensuring that effective governance is implemented in the South African Public Service and this requires effective managerial leadership.